Unemployment Insurance and Work Effort: Issues, Evidence, and Policy Directions

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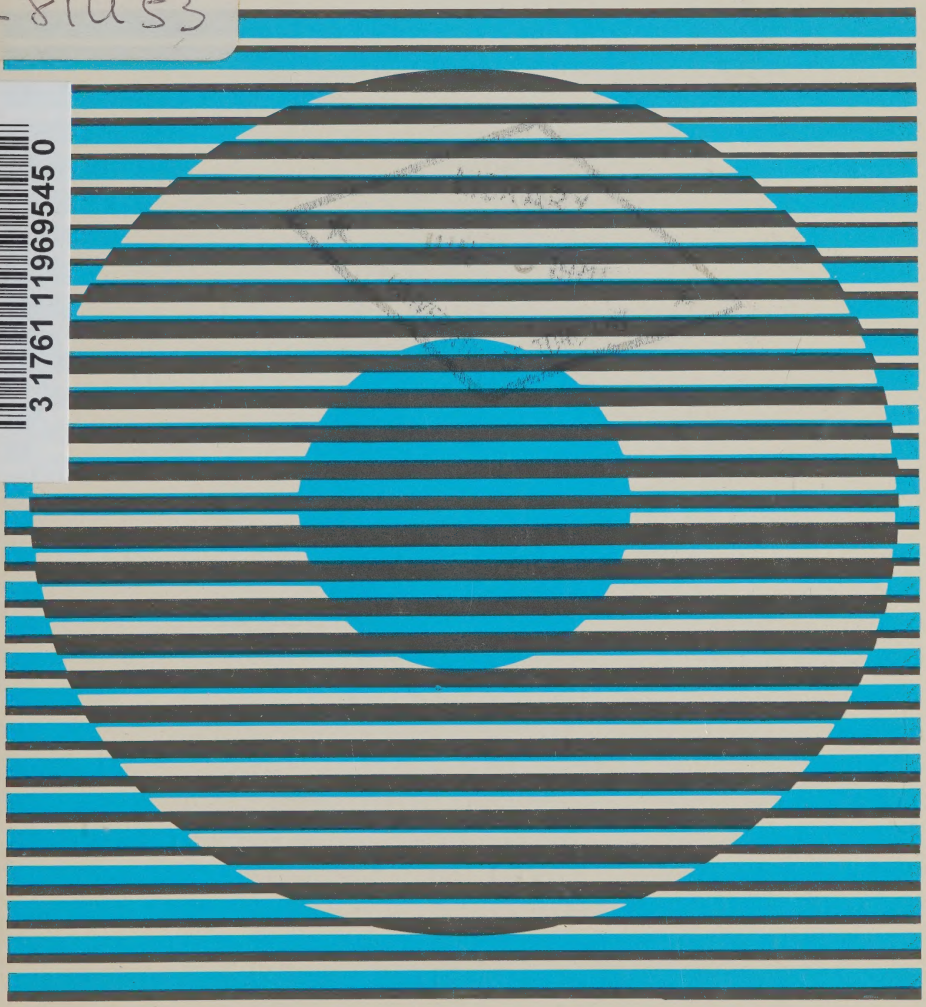
Derek P. J. Hum

Discussion Paper Series



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INTRODUCTION

The possibility that unemployment in Canada may be increased by unemployment insurance is one of the principal questions being studied in the government's ongoing review of unemployment insurance. There is a substantial body of literature and empirical studies on this question, but most of it is scattered, inaccessible, and difficult to understand without technical training. As a result, both federal and provincial policy-makers, as well as concerned citizens, have little appreciation of the academic debate on the subject. This paper will review that debate and the body of evidence. I shall concentrate on work incentives, induced unemployment, and income support policy. The view is taken that a discussion of unemployment insurance in Canada must consider broader issues of social welfare policy. The structure of the paper is as follows. The first section provides general background and a brief history of the Unemployment Insurance Program. It concentrates on the objectives and design of the present program and discusses some significant changes made during the seventies. The next section outlines the hypothesis that unemployment can be induced by unemployment insurance and reports the results of various empirical studies of the effect of unemployment insurance on measured unemployment in Canada. The following section mentions a number of related issues connected with unemployment insurance in Canada and suggests matters for further research and discussion. The final section consists of a summary and concluding remarks.

UNEMPLOYMENT INSURANCE IN CANADA: GENERAL BACKGROUND

Unemployment and government responsibility

High unemployment has become common in Canada. What are some of the reasons for our high unemployment rate? Are Canadians unemployed because there are not enough jobs or because they voluntarily choose unemployment? What is the effect, if any, of unemployment insurance on unemployment?

John Maynard Keynes believed that unemployment was caused by insufficient demand for goods and services. There might of course be a number of unemployed workers not matched with unfilled jobs at any given time, but this degree of unemployment was considered as 'friction' in the economy. Unemployment in excess of this frictional amount is considered

involuntary, and the principal cause of involuntary unemployment, according to Keynesian doctrine, remains deficient aggregate demand.

Insufficient aggregate demand for goods and services may well be a plausible explanation of involuntary unemployment, but it is based on aggregate concepts and undoubtedly masks countless subtleties and details. For example, what importance ought we to attach to the changing role of women in the economy and their desire for market work? What has been the effect of new technology on skill requirements for labour and on the kinds of jobs in our society? Has there been a dramatic change in our society's attitude towards the work ethic, the commitment to individual income security, and the pride and status associated with gainful employment? In short, while macroeconomic explanations in terms of deficient total demand may well account for a certain measure of involuntary unemployment, might there not also be people who choose not to work? If there are such people, why are they voluntarily unemployed? Do they number in the thousands or the hundreds of thousands?

A final question, but a most significant one for government policy, is whether unemployment insurance is a major means of support for households containing unemployed individuals.

One legacy of Keynes is the belief that governments have a role to play even in a predominantly market economy. Governments nowadays explicitly recognize some responsibility for maintaining employment and individual incomes. This acknowledgment often leads them to set a target of full employment and to take steps to promote full employment. While governments continue to affirm the value of individual initiative, self-reliance, thrift, and personal pride, they also willingly accept the fact that not all the unemployed necessarily lack those virtues. Consequently, people without jobs need not be left to slow strangulation by the proverbial 'invisible hand' of a self-regulating economy.

In Canada, wages constitute the bulk of household income for most families. Consequently, loss of employment by individuals can result in a drastic fall in a family's standard of living and, in the case of poor families, inability to pay for basic needs. In recognition of this situation, unemployment insurance is now a major part of Canada's extensive social security system. In 1975 it accounted for 26.1 per cent of all social security transfers (Cloutier 1978, 2). Social security payments administered or funded by the federal government, either alone or jointly with the provinces under cost-sharing agreements grew from 4.3 per cent of

Canada's Personal Income in 1946 to 11.2 per cent in 1975-6 (Statistics Canada 1978, 31).

It is frequently alleged that these unemployment insurance payments diminish the incentive to work and induce voluntary unemployment. For example, it is believed that individuals voluntarily unemployed may pretend to be looking seriously for work, prolong their spells of unemployment, harbour exceptionally high job expectations, contrive to become eligible for benefits, deliberately lose their jobs, and the like. The list of indictments is almost endless. It is ironic that a compassionate program intended to lessen the hardships of the involuntarily unemployed may well have the unintended consequences of increasing unemployment. The generosity of the program becomes a prime cause of its ultimate failure in the minds of its critics, and the integrity of the program becomes undermined.

The problem of income support and work incentives has a long history. What to do with those able-bodied members of society without gainful employment has long been a problem. The difference today is that in Canada it is the federal government, rather than private charity or the Church, that now bears that responsibility, and it is through unemployment insurance rather than the dole or the workhouse that relief is granted. What has been constant throughout has been society's sense of values - namely, that the able-bodied are expected to work, to be self-reliant and independent, to prefer employment to unearned income transfers, and to call upon the State's compassion only under the most unfortunate and unavoidable circumstances visited upon them by a government's failure to assure them of a job.

It is clear that strong emotions will unavoidably accompany any discussion of income support policy and work disincentives. Modern writers argue the issue no less energetically than their nineteenth century counter-parts, but they contribute a more careful analysis of labour markets, individual behaviour, and work disincentives as well as a series of statistical investigations into the present-day experience of unemployment insurance.

Social objectives and the Unemployment Insurance Program

In 1940 the Royal Commission on Dominion-Provincial Relations recommended the introduction of unemployment insurance in Canada. The Employment and Social Insurance Act was passed by Parliament in 1935, but the

Supreme Court declared the act ultra vires in 1937. Eventually the constitutional difficulties were settled, and the Unemployment Insurance Act became law on 7 August 1940. Contributions to the program became payable in 1941, and by February 1942 claimants were receiving benefits. That act remained basically unchanged for thirty years until 1971, when a number of important revisions were enacted. The 1971 changes were preceded by a full-scale review of the act by Parliament in 1968 and a re-examination of the role of unemployment insurance in Canada's social security system in 1970. Partly in response to mounting criticism of the 1971 revisions, the Unemployment Insurance Act was again amended in 1977.

The major declared objective of the Unemployment Insurance Program remains the provision of insurance against the interruption of earnings resulting from unemployment. The Unemployment Insurance Commission itself gave a concise statement of that objective in the early sixties (Committee of Inquiry into the Unemployment Insurance Act 1962). What was intended was a social insurance program under which benefits were to be payable to persons having an insurable risk against 'loss of employment and the earnings therefrom.' It added that a person 'not normally in insurable employment to a substantial extent and within a recent period of time has nothing of substantial value to lose and cannot have an insurable interest' (p. 20).

There are other objectives of the program that also deserve to be mentioned. For example, the introduction of the seasonal benefit in 1955 recognized the difficulties of seasonal workers. The role of unemployment insurance in manpower placement policies is also significant. Originally, the Unemployment Insurance Commission was closely tied to the National Employment Service, whose object was to accelerate the return to the labour force of unemployment insurance claimants. The placement function and the insurance function were separated in 1966, and by 1970 little or no communication occurred between the placement service and the Unemployment Insurance Commission. In 1977, however, the Unemployment Insurance Commission was merged with the Department of Manpower and Immigration to form the Department of Employment and Immigration. A single commission now looks after the payment of unemployment insurance benefits as well as manpower placement, training, counselling, and other employment programs (Statistics Canada 1978, 113-4).

The original unemployment insurance program did not concern itself with redistribution of income. It was funded by its participants on an

'insurance' principle. Hence, any income redistribution was small and indirect and occurred through general government funding to the program. Gradually, redistribution became an objective and coverage of some individuals not suitable from a strictly insurance point of view has taken place. Today, there is greater emphasis on income redistribution; this is condemned by some (Kapsalis 1978) and praised by others (Cloutier 1978, Osberg 1979b). Finally, there have also been changes in the Unemployment Insurance Program in order to accommodate economic stabilization and regional transfers. At first the program sought primarily to maintain the purchasing power of individuals (and, no doubt, general aggregate demand). The introduction in 1950 of the Supplementary Benefits, which became the Seasonal Benefit in 1955, signalled an increasing use of the Unemployment Insurance Program to achieve some degree of economic stabilization. At present there are even regulations in the program to help depressed regions of the country. (See Bird 1976 for a more detailed discussion of the objectives of unemployment insurance.)

It is clear that the Unemployment Insurance Program has had, and continues to have, a wide range of effects on Canada's economy. Because its role in lessening the financial hardship of the unemployed is undeniably paramount, this paper will concentrate on the program from the perspective of social welfare policy.

Unemployment insurance in the seventies

Although the objective of the Unemployment Insurance Program, namely, to provide insurance against the loss of earnings, has not altered, the regulations of the program have changed from time to time. In general, employees make contributions from earnings (along with employers). The amount and duration of benefits are determined partly by past earnings in some base period of employment. The duration for which benefits are paid, the level and structure of benefits, the initial waiting period, the conditions determining eligibility, the maximum benefits and contributions, the taxation of receipts, the cause of employment termination, job search activity, and so on - all these regulations are often and easily altered, and, unlike major policy declarations, they frequently escape the scrutiny of the public.

The Unemployment Insurance Program underwent considerable substantive and administrative changes in the seventies. The decade started

with a new, more generous Unemployment Insurance Act in 1971, in which virtually every regulation was liberalized. The coverage became almost universal, the qualification period was reduced, the benefits were extended, the insurable amounts were raised, the definition of interrupted earnings was broadened to allow sickness, maternity, and retirement as grounds for claiming unemployment insurance. Whereas before 1971 unemployment insurance covered mainly middle- or low-income workers, who constituted about 80 per cent of the labour force, the 1971 act made coverage almost universal (95 per cent of the labour force); it included any labour force member in an employer-employee relationship, even members of the armed forces. Previously, a claimant had to have contributed for thirty weeks in the past two years with at least eight weeks in the past twelve months to qualify for benefits; the 1971 act required only eight weeks of contributions in the previous fifty-two weeks. The new act raised the maximum weekly benefit from $53 to $100 and indexed this amount by an escalation clause. As a result, the average weekly benefit in 1972 represented 41 per cent of average weekly wages and salaries, compared with 29 per cent during 1953-72 (Grubel, Maki, and Sax 1975a, 182). However, effective with the new act, benefits became taxable income, while contributions became allowable deductions for income tax purposes. Hence, while the ratio of average weekly benefits to wages increased in 1972, the increase from 29 to 41 per cent is misleading. Finally, the new act allowed for a distinction between those having a minor and a major attachment to the labour force, and for variously defined benefit periods. Unlike the old act, the 1971 act no longer calculated duration of benefits solely by contribution history: benefits are now based partially on the national and regional unemployment rates.

There can be little doubt therefore that the 1971 Unemployment Insurance Act was a considerable liberalization. Its effect was quickly recorded in the increased number of claimants and larger benefit payments. The number of claimants rose from a monthly average of 603,547 (or 7 per cent of the labour force) in 1971 to over one million (about 10 per cent of the labour force) in 1976. Total net payments paid out under the program were $890.6 million, or 1 per cent of GNP in 1971, and $3,342.2 million, or 1.8 per cent of GNP in 1976 (Statistics Canada 1978, 141-3, 153).[1]

1 See Cloutier (1978) for a discussion of the distributional incidence of net benefits. He finds that the program is regressive and that it became increasingly so from 1971 to 1975.

The new Unemployment Insurance Act was also ushered in under unusual labour market circumstances. The national unemployment rate appeared sticky at its cyclical peak in 1971; job vacancies, instead of falling as expected, rose steadily until 1974, and the labour force grew at a rate remarkably higher than its historical average or than it had during the preceding five years (Green and Cousineau 1976, 406). But it was undoubtedly the details of the new act's liberal procedures and the subsequent rapid rise in government benefit payments that aroused the public's ire. The outcry, especially in the press, reached large proportions in the mid-seventies. Nor was the mood of the public helped by rising oil prices, budgetary restraint, and the slow growth of the economy.

In the second half of the seventies, the movement towards liberalization was abruptly halted and reversed. In 1975 the maximum disqualification period for voluntary quitting was increased from three weeks to six weeks, and in 1978 the eligibility requirements were made stricter, benefits were decreased, and the base qualification period was lengthened.[2]

Once again the Unemployment Insurance Program is now being reexamined by the government, and a major issue in this review is the possibility that a generous unemployment insurance program might itself cause some unemployment. We turn now to a consideration of that question.

INSURANCE-INDUCED UNEMPLOYMENT

Choosing work or unemployment: What are the incentives?

According to traditional economic theory, an individual will want to buy a certain amount of consumer goods as well as enjoy a measure of leisure, i.e. non-working time. The amount of goods and services an individual can buy is limited by his buying power, or wage earnings, which, in turn, is determined by the number of hours he works. If we assume that prices and wages are fixed, more commodities can be purchased only by more work effort (less leisure). The problem for the individual is to choose the combination of income and leisure that he regards most

2 See Osberg (1979a) for a review of the Bill C-27 amendments.

satisfying. Clearly, the relationship between prices of goods, wage rates, and the level of earnings will greatly influence the combination chosen. A higher wage rate would mean that less work effort is required to buy a certain amount of commodities or that for the same amount of work effort a higher level of earnings is possible. According to this theory, only consumer goods and leisure are desired directly, and work effort is supplied solely in order to earn income to buy goods. Therefore the theory predicts that, should an individual be so fortunate as to inherit a lifetime or even fixed-term annuity, voluntary unemployment would result since the incentive to work would have been removed.

Now imagine an unemployment insurance program that deducts a tiny fraction of an employee's earnings (say, 1.4 per cent) each week. After a number of weeks worked (say, eight weeks) the individual is entitled to sizeable benefits (say, two-thirds of earnings) if he should become unemployed. These benefit payments are subject to income tax. The regulations also set out a waiting period and a maximum level of benefits, as well as a formula relating benefits to economic indicators. In addition, an unemployed individual is required to search for a job in order to receive unemployment insurance benefits.

It is not difficult to see how such an unemployment insurance program might be a disincentive to work. The important question is: will this work disincentive lead to higher unemployment for an individual and for the economy as a whole? Unemployment insurance essentially reduces the cost of being without a job if the individual is eligible to receive benefits. Without unemployment insurance the cost of being unemployed is the earnings forgone by not working. Those earnings are necessary to buy goods, but they must be 'paid for' by sacrificing leisure. At some (reservation) wage rate the individual will view the after-tax monetary returns from working as compared to the sacrifice of leisure time as unacceptable. He may withdraw from the job market and in doing so become 'voluntarily' unemployed. By providing cash benefits, unemployment insurance considerably lessens the sacrifice involved in quitting a job. In addition, if the marginal tax rate is very high, this reinforces the disincentive to work by lowering the after-tax wage return. Therefore, unemployment insurance will induce individuals with a strong distaste for their line of work to quit their jobs or prolong their periods of unemployment, or both. Because job attachment is weakened, job turnover may increase in the labour market. Consequently unemployment in the economy

will increase if enough job leavers enter the ranks of the unemployed to collect benefits[3] and if, for some reason, their vacated jobs are not filled by someone previously unemployed. According to this theory there is no involuntary unemployment in the economy; for it there were, the former jobs would be accepted by those involuntarily unemployed who had less strong preferences for leisure. Alternatively, various structural barriers must be present to explain the presence of increased voluntary unemployment induced by unemployment insurance alongside involuntary unemployment. This would be the case, for instance, if the involuntarily unemployed were discriminated against or were unable to move to where there were jobs available.

It has also been argued that unemployment insurance may prolong spells of unemployment by enabling individuals to take more time to search for better-paying jobs. This will not necessarily lead, however, to an increase in the unemployment rate in the economy. It is equally possible that longer periods of job search may enhance the efficiency of labour markets and reduce longer-term or structural unemployment.[4] Individuals may also search for more attractive jobs.[5] Accordingly, while unemployment insurance benefits may induce a longer period of job search for some individuals, it is not certain that the economy's unemployment rate is increased as a result.

Unemployment insurance, it is suggested, may also increase unemployment by enlarging the size of the labour force through increased labour force participation. The possibility of obtaining benefits after a

3 This is addressed directly by the bulk of the empirical research, which concentrates on the benefit/wage ratio. The choice is between being employed (and receiving wages) and being unemployed (and receiving benefits). It is easy to see why this ratio is the most significant parameter. The ratio is also referred to as the replacement/earnings ratio. (See Munts and Garfinkle 1974.)

4 See Burdett (1979) for a recent theoretical contribution analysing this effect. He obtains the interesting result that unemployment insurance has an adverse incentive effect on job search for the short-term unemployed and a positive incentive effect on the long-term unemployed. Marston (1975) provides empirical evidence for the view that unemployment insurance prolonged unemployment spells in the United States by subsidizing job search. See Maki (1977) and Lazar (1978) for an analysis of Canadian data.

5 Feldstein (1973) emphasizes the attractiveness of jobs. He has argued that the U.S. labour market in the early seventies was one in which lengthy job search was unnecessary. Anyone could find his customary job in a short time. The problem was not 'job unavailability' but 'job unattractiveness.'

short qualifying period of work may well increase the attractiveness of part-time work or attract new job market entrants whose main purpose in working is the prospect of future unemployment insurance benefits. Since work is now remunerated with the current wage as well as subsequent unemployment benefits, the monetary rewards to an hour of work are much higher than they would otherwise be. Consequently, those who were previously unwilling to work for the market wage alone might now do so after taking into account the expected unemployment insurance benefits. After working long enough to qualify for benefits, these individuals voluntarily quit. They remain officially in the labour force by pretending to look for jobs in order to receive benefits, and their unemployed state increases the overall measured rate of unemployment. On the other hand, since individuals are induced to accept employment by the program in the first place, this reduces the unemployment rate. Hence one cannot without additional assumptions specify whether or not unemployment insurance will lead to greater unemployment. The number of people attracted to employment may more than offset the number of individuals who are induced to participate and then quit.[6] Finally, the ease with which the program is admininistered may affect the number of registered unemployed. If disqualifications are infrequent, if job search requirements are minimal, waiting periods trivial, and so on, the size of the covered population and the number of unemployed may both increase.[7]

It is obvious that unemployment insurance programs contain both positive and adverse incentives for individual labour supply. Furthermore, general economic conditions, particularly the demand for labour, cannot be ignored in any discussion of induced unemployment. The Unemployment Insurance Program is also an 'automatic stabilizer,' and by maintaining individual or regional incomes could actually lower the unemployment rate through its support of aggregate demand.[8] Similarly, the

6 See Hamermesh (1979) for evidence for the United States. Swan (1975) reports that the 1971 act increased the measured participation rates in Canada.

7 Holen and Horowitz (1974) find that administrative strictness is more important than benefit levels in determining the level of unemployment. See also a recent study by Felder (1979). Incidentally, the complexity of the UI regulations has new reached the point where, like Canada's income tax, it has spawned its own 'how to' manual and practical guide. See Schneider and Solomon (1977).

8 Fine and Nagarajan (1976) used an econometric model of Prince Edward Island to estimate that for each one million dollars inflow of UIC payments to PEI, ten additional jobs result.

program may actually increase labour supplies and foster greater market efficiency, particularly if prolonged job search leads to better matching of employees and vacancies, increased job satisfaction, or an increased flow of labour force participants (see Hamermesh, 1979). Finally, while a stylized model of how unemployment insurance fosters increased work disincentives among individuals is possible, it would be very difficult to develop a cogent theory relating the aggregate unemployment rate in the economy to micro motives. As seen above, a host of additional conditions would also have to prevail. The net effect of unemployment insurance on the measured rate of unemployment is theoretically ambiguous and is essentially an empirical question. Nonetheless, the program's regulations can make a large difference to the balance between adverse and positive incentives. Thus the benefit/ wage ratio, the taxation rate implied by the program for those who decide to intermix work and unemployment, and the entitlement and continuing eligibility conditions are major factors. The possible effects are prolonged duration of unemployment, increased job turnovers, and increases in labour force participation rates - effects which, if they indeed exist, can increase unemployment in the economy.

Individual and economy-wide views of unemployment

Whether or not unemployment insurance raises the unemployment rate is essentially an empirical question, and for that reason it is natural to look to actual data for an answer. Aggregate statistics (macro data) on rates of unemployment, which are easily obtained, tell us what percentage of the labour force did not have a job. The labour force is defined to consist of those who actually held jobs and those who were looking for work. Recall, however, our description of the individual making up his mind whether or not to work. If the unemployment insurance program results in intermingling of employed periods and jobless spells by individuals, then the measured unemployment rate of the economy will be decreased or increased according to whether individuals are accumulating entitlements or drawing benefits at the time the unemployment rate is measured. The unemployment rate in such circumstances might be better defined as the percentage of time in a given period that the individual is not working. And in order to investigate whether or not unemployment insurance has caused an increase in the unemployment rate in this sense, one requires data on individuals (micro data) over time.

Regardless of what kind of data one uses, it is important to note their limitations. For example, macro data may be able to relate the unemployment rate, defined as the percentage of the labour force without a job, to such determinants as the level of aggregate demand or to some average benefit/ wage ratio in the economy and the like. But such data are unlikely to shed any light on the effect of unemployment insurance on the unemployment rate through prolonged duration of individual unemployed spells, increased job turnovers among individuals, and the like. Also we are likely to learn little about individual job search activity, the use of non-work time, and so on. The latter information is important for policy purposes since the way that society values leisure time may depend on whether it is financed by unemployment insurance or personal savings. It matters appreciably whether this non-market time is used by an individual to search for a job, to undertake manpower training, to look after children at home, or to ski. Micro data over time could give us some of this information.

Micro data, however, are not without their defects. For example, because they are limited to the behaviour of individuals, they are not suited to an investigation of the possible influence unemployment insurance might have on structural unemployment by increasing seasonal layoffs or maintaining marginal seasonal employers (Grubel, Maki, and Sax 1975a, 185, fn. 7 and Bird 1976, 194-5). Similarly, micro data are incapable of capturing the effect of unemployment insurance on the mix of industries.[9]

Review of selected evidence for Canada[10]

One of the first studies in Canada on whether or not unemployment insurance affects the overall rate of unemployment was by Grubel, Maki, and

9 Explicit experimental data on labour supply effects are rare, although Canada has collected, but not yet analysed, data of this type in the context of a guaranteed income or negative income tax (NIT) experiment. See Hum et al. (1979a, b, and, c) for a description of the experiment's design, sample, and payments system. The United States has funded four NIT experiments. The background and a survey of the work disincentive findings of these experiments are contained in Hum (1980a and b). Rea (1977, 267) has demonstrated that after a certain number of weeks the unemployment insurance program is identical to an NIT with a tax rate of k, the benefits/earnings ratio, and a guarantee of 51 kw, that is 51k times the weekly wage, w.

10 This review is confined for the most part to published Canadian material that is readily available.

Sax (1975a), who attempted to estimate the magnitude of the increase in unemployment attributable to the 1971 Act. Because the passing of the 1971 Unemployment Insurance Act was a rather dramatic and generous overhaul of the Unemployment Insurance Program, it provided an excellent opportunity for testing hypotheses related to insurance-induced unemployment. Using annual time-series data for 1953-72, Grubel, Maki, and Sax (1975a) estimate a four-equation model and find that, among other things, the benefit/wage ratio, the male and female labour force participation rates, and a variable intended to capture administrative enforcement procedures were all significant in explaining the rate of unemployment. The authors calculate that 'the new unemployment insurance legislation ... raised the reported rate of unemployment by 0.8 percentage points' (187).[11] They suggest that in 1972 about one-fifth of total unemployment was of the induced variety.

The Grubel-Maki-Sax findings have not gone unchallenged. Reservations have been expressed about the study's statistical methods, measurement, the adequacy of its data, and the model specification. Kaliski (1975) questioned whether annual data can tell us much about administrative practices. He also asks whether seasonal effects might not be important. Seasonal aspects were ignored by Grubel, Maki, and Sax because they were using annual data. Subsequent attempts by Kaliski (1976) to test the effect of unemployment insurance benefits on seasonality of unemployment have not proved very successful.

A more damaging criticism of the Grubel-Maki-Sax findings was made by Kaliski (1975), who wondered whether the fact that unemployment insurance benefits became taxable in 1972 might not upset the results. Grubel et al. (1975b) re-estimated their equations, assuming alternatively the tax rate applicable to benefits in 1972 was either 10 per cent or 20 per cent. They find that with a 10 per cent tax rate the previously estimated increase of 0.8 percentage points in the unemployment rate induced by the 1971 legislative revisions now falls to 0.5 percentage points. With an income tax rate of 20 per cent, the 1971 revisions would have no effect at all on unemployment rates.[12] In another context, Cloutier (1978, 40)

11 Maki (1975) has also estimated the regional effect of the insurance-induced unemployment for Canada and finds wide variations. The amount of induced employment may be eight to fourteen times greater in the Atlantic region than in Ontario.

12 Kaliski (1976, 706) interprets the retreat of Grubel, Maki, and Sax

estimates the marginal income tax rate paid on benefits averaged across all benefit recipients to be 17.35 per cent in 1975. In other words, the actual tax rate paid on UI benefits is fairly close to the 20 per cent at which the Grubel-Maki-Sax (1975b) study implies unemployment insurance had no significant impact.

The Grubel-Maki (1976) approach has also been criticized on grounds of method and interpretation.[13] Specifically, Hamermesh (1978, 46) notes that the Grubel-Maki estimates imply that if unemployment insurance were abolished (in the sense that the benefit/wage ratio is reduced to zero) unemployment would be zero, 'a result that is difficult to credit.'

A large part of the difficulties associated with the results of Grubel, Maki, and Sax (1975a) have to do with the inherent nature of macro data. An investigation of the 1971 revisions to the Unemployment Insurance Act using different data was made by Green and Cousineau (1976). Focusing upon the years 1972 and 1973 and applying a macroeconomic model, the authors find that the 1971 revisions were responsible for an increase of about 0.7 percentage points in the unemployment rate (p. 114). In addition, Green and Cousineau use unemployment insurance disqualification statistics together with estimates of labour supply responses borrowed from guaranteed income studies to estimate the effect of the 1971 Unemployment Insurance Act on the unemployment rate. The authors conclude that the Unemployment Insurance Program contributed about 1.1 percentage points to the unemployment rate and that the 1971 revisions account for between 0.4 and 0.7 percentage points. The Green-Cousineau study also points out two other important aspects of unemployment insurance and work incentives, namely, the family as an economic unit, and the influence of marginal tax rates on work incentives. On the first aspect, Green and Cousineau describe the increasing importance of

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(1975b) as a concession on their part that one 'cannot tell whether or not the 1971 revision had an effect on the 1972 rate of unemployment.' The issue really concerns data and measurement. Grubel et al. (1975b) cite the observation by Munt and Garfinkel (1974) that the benefit/wage ratio should be adjusted for all income taxes, payroll taxes, and fringe benefits. The difficulty is the inappropriateness of aggregate data for measuring the benefit/wage variable facing individuals.

13 Hamermesh's (1978) comments were directed at Grubel and Maki's (1976) findings with respect to the United States and not Canada. I am taking the liberty of assuming that Hamermesh would allow his criticisms to apply to the Canadian application as well since the model framework and estimation method is essentially the same in both cases.

'secondary workers and multi-earner families in the unemployment picture' (p. 28). In essence unemployment for any particular individual has largely become a family affair in that job search, job quits, and labour force entry or exit decisions for an individual will depend largely on the labour force status and earnings of other family members.[14]

Green and Cousineau (1976) also highlight the importance of marginal tax rates on work effort. The ratio of unemployment insurance benefits to average wages (the benefit/wage ratio) has been identified by economists as a major factor affecting unemployment. This variable represents the relative income rewards from unemployment compared to work. However, marginal tax rates play an important role as well. This was noted by Grubel, Maki, and Sax (1975a, 189), who write: 'one way of looking at the cause of the induced unemployment is to consider that under the current system the marginal tax rates on work are extremely high in the sense that, when switching from unemployment benefits to work, employment is rewarded by only the small amount of extra income which represents the difference between the unemployment insurance benefits and wages.' Green and Cousineau (1976, 38) provide calculations of the marginal tax rates for workers moving from unemployment benefits to wages. The tax rates are extremely high: approximately 70 per cent for single individuals, husbands with non-working wives, and working wives with children. For working wives who must pay for child care, the marginal tax rate is about 90 per cent. Green and Cousineau's (1976, 39) figures show that the new Unemployment Insurance Act substantially increased the implicit tax rate of the Unemployment Insurance Program. 'The present unemployment insurance tax rate now exceeds by 9 percentage points the highest tax rate under the existing personal income tax system.'[15] The clear implication is that work incentives are being eroded by very high marginal tax rates.

14 The reservation wage acceptable to an individual, the duration of unemployment, the readiness to enter or leave the labour force as well as the equinimity with which one views job tenure and income security can definitely depend upon whether or not anyone else in the family is working or receiving income. Family circumstances could affect an unemployed individual's decision to stop seeking work (discouraged worker effect). Similarly, the unemployed status of one family member could lead another member to enter the labour force (added-worker effect).

15 In many social welfare programs the implicit income tax is camouflaged as the benefit-reduction rate. The tax rate has been identified as a major parameter affecting work incentives and was explicitly varied in

Two interesting studies that simulate the effect of the 1971 Unemployment Insurance Act on unemployment are Siedule, Skoulas, and Newton (1976) and Rea (1977). The former use a large econometric model of the Canadian economy (CANDIDE), characterize a number of age-sex labour groups, specify group-specific participation rates, and define a summary measure of labour supply effort. After performing simulations, the authors believe that the unemployment rate was about three-quarters of a percentage point higher in 1972 than it otherwise would have been as a result of the 1971 legislative changes to the Unemployment Act. Bodkin and Cournoyer (1978) have argued that this is too low an estimate. They 'guess' that the figure is closer to 1.3 percentage points. Nonetheless, the outcome of Siedule, Skoulas, and Newton's effort is to confirm the broad results obtained by other authors and to distribute the effect among various groups.

A different approach is taken by Rea (1977) in his interesting simulation of the 1971 Unemployment Insurance Act. Rea estimates a labour supply function using data from the Unemployment Insurance Commission's data base on individuals in covered employment between 1966 and 1970. He then performs simulations to analyse the relative importance of changes in the program's regulations that were made by the 1971 Unemployment Insurance Act. Measuring the response effect in terms of changes in weeks worked, Rea is able to determine which program changes increase work incentives and which decrease work incentives. He finds that increased benefits account for the largest reduction in work supply (-8 per cent). Making benefits taxable and increasing the waiting period, however, increases work effort by 2.9 and 2.5 per cent respectively. Altering eligibility conditions reduces work effort by 2.1 per cent, and extending benefits to regions where the unemployment rate exceeds a certain level reduces work effort by 0.1 per cent. The total effect of all these changes, positive and negative, is -4.8 per cent. Rea's work is important for establishing the direction and magnitude of effects attributable to specific changes in the program. But how does his estimate of a 4.8 per cent reduction in work effort translate into a change in the unemployment rate? The answer to this question is not easy. If all unemployment is

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the various negative income tax experiments. One of the experiments reported that higher marginal tax rates resulted in greater work reductions (see Hum, 1980b).

voluntary, as assumed by Rea's model, and if all those claiming benefits in 1972 were to respond to the provisions as predicted, the 'unemployment rate would have been 1.6 percentage points lower without the Unemployment Insurance Program' (ibid., 277). But as soon as some involuntary unemployment exists, the matter is much more complicated since 'involuntarily unemployed workers ... can replace those who reduce their work' (ibid). In other words, the existence of involuntary unemployment makes the leap from a reduction in work hours to increased unemployment rates a problem. The effect of aggregate demand and the like is also very important. In a study for the Unemployment Insurance Commission, Jump and Rea (1975) used the University of Toronto Quarterly Forecasting Model to simulate the macro effects of the 1971 Unemployment Insurance Act. Their simulations imply that the 1971 revisions had very little influence on measured unemployment rates because of a strong stimulative effect on aggregate demand. Fine and Nagarajan (1976), as previously noted, find that unemployment insurance benefits create about ten jobs per million dollars transferred to Prince Edward Island. Similarly, Swan, MacRae, and Steinberg (1976) find that income maintenance programs in general can cause a substantial increase in aggregate demand, creating as many as 4,700 jobs in the Maritimes in 1972.

According to my selective review of the evidence, the Unemployment Insurance Program may induce non-trivial amounts of unemployment, although there is disagreement about its magnitude. However, the 1971 revisions were an unusually sharp change and perhaps one should not overgeneralize from them. While the effects of unemployment insurance on the unemployment rate are ambiguous, depending as they do on the characteristics of the unemployed, the state of the labour market, and so on, the adverse incentive for individuals is nevertheless there. This is because unemployment insurance benefits are a form of income that is, in one sense, unearned.[16]

Assuming that the program will not be abolished, attention should be focused on the program's various regulations. We should also not forget that the stimulative effect of unemployment insurance transfers on aggregate demand may well counteract any increase in insurance-induced un-

16 If one views the program as insurance, then benefits are earned in the sense that contributions were made. What we simply mean is that the amounts are unrelated to current work effort. Job search activity is also not considered a job, although the Unemployment Insurance Program

employment. This is clearly the conclusion one is tempted to draw in light of the whittling down of the induced-unemployment effect initially estimated by Grubel, Maki, and Sax and the strong stimulative impact on aggregate demand reported by Jump and Rea (1975).

It is helpful to reconsider what a high rate of unemployment is supposed to signify. It can be seen as an economy-wide measure of unused manpower (i.e., the economy could be producing more) or as a measure of the number of individuals spending part of their time not working, either involuntarily or voluntarily, (i.e., indicating hardship or sloth). Whatever one's point of view, unemployment insurance promises to occupy centre stage in future debates on unemployment issues.

UNEMPLOYMENT INSURANCE AND SOCIAL WELFARE POLICY

Insurance or income maintenance

Although the design and funding of the Unemployment Insurance Program have changed considerably since its introduction, the controversy continues as to whether unemployment insurance is wage insurance or income maintenance. Some argue that even a strict application of private insurance principles cannot eliminate the insurance character of the program. (Kapsalis 1978, 1979) Others believe that unemployment insurance in Canada is already a long way from normal 'insurance practices' (Cloutier 1978, Osberg 1979b). While differences in policy recommendations can be directly attributed to divergent viewpoints concerning whether unemployment insurance is insurance or welfare, the issue whether or not the program itself induces greater unemployment is unaffected.

Those who view the program as social insurance refer to 'moral hazard,' by which is meant the notion that the incidence of any hazard is greater whenever its victims are insured against losses. In the case of unemployment insurance the benefit payments reduce the costs of unemployment, and consequently the opportunity for an individual to bear only some fraction of the risk - termed co-insurance - increases the incidence of the event, namely unemployment. Because the program reduces

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requires and finances this activity. Indeed, since benefits are considered subsidies for job search, unemployment insurance may be lightheartedly viewed as a federal cost-sharing program for individuals. Let us hope that block-funding is not just around the corner.

the income loss of the unemployed, 'co-insurance' and 'moral hazard' explain induced unemployment 'in the sense that if the unemployment insurance program did not exist, the incidence of the event "unemployment" as conventionally measured would be less pronounced' (Grubel and Walker 1978, 13).

Others who see unemployment insurance as income maintenance will also reach the same conclusion but with different language. Since the program is designed to provide cash transfers to the unemployed, the benefits constitute income unrelated to hours worked. Viewed over a longer period in which there are spells of employment and unemployment, the wage receipts and benefits will alter the effective income taxation rates faced by workers. The work disincentive effects of taxation rates and unearned income - termed substitution and income effects by economists - are well known. They may lead to voluntary quits, prolonged spells of unemployment, insincere job search, and so on, and those may lead to higher unemployment in the economy.

Whether one views unemployment insurance as largely insurance or income maintenance is not an issue as far as the possibility of induced unemployment is concerned. Both views lead to the same prediction. The more relevant observation is that in our market society command over goods and services is still largely determined by income. For most families, wage earnings still constitute the bulk of income receipts and are therefore directly related to the supply of work. Once that connection is severed, whether by insurance payments or welfare benefits, the incentives to work are weakened and unemployment may increase.[17]

On the other hand, policy suggestions are likely to depend on what one considers to be the proper role for unemployment insurance. In any social security program one cannot ignore the questions of adequacy and delivery, or more prosaically, how much, and how? In the case of unemployment insurance this requires decisions about benefits, earnings, and necessary expenditures. Benefits may or may not replace a sufficiently high fraction of earnings and may or may not be sufficient to cover expenditures for basic needs. Therefore those who want the Unemployment Insurance Program to reflect insurance principles (e.g. Kapsalis 1978) will

17 It is assumed that individuals are indifferent as to whether income receipts result from employment or from unemployment insurance benefits. A dollar is supposed to be simply a dollar and, by any other name, will buy just as much (or less). As well, people are assumed to work for money and not for love.

concentrate on the benefit/wage, or earnings-replacement, ratio. They find nothing inequitable about the present structure of relatively uniform benefits and contributions since it is compatible with group insurance practices. On the matter of the relationship of benefits to necessary expenditures, Kapsalis finds the insurance program merely deficient in offering 'the same degree of income protection regardless of the extent of potential hardship resulting from unemployment' (ibid. 27). He therefore calls for a more flexible ceiling on insurable earnings. Since he views the program as insurance, it is not surprising that he suggests that the program be changed to allow people to 'buy' more insurance.

Cloutier (1978) and Osberg (1979a and b) have rejected the notion that the present Unemployment Insurance Program is exclusively a wage-loss insurance program. They concentrate on the relationship between benefits and expenditures, that is, adequacy. Cloutier (1978), in his concern for distributional equity of both contributions and benefits, finds that the only net contributors to unemployment insurance are family heads with after-tax family incomes of $8,000 or greater. He rejects the insurance viewpoint (ibid. 47) and proposes that the target efficiency and equity of the Unemployment Insurance Program be increased by paying benefits to unemployed individuals 'on the difference between family insurable earnings and family income' (ibid. 48). Osberg (1979a and b) advocates that 'benefits received by a family ... be declared as the income of the highest income spouse (1979a, 231). Both he and Cloutier regard unemployment insurance as income maintenance. Accordingly their suggestions are intended to increase equity and target efficiency, either by increasing benefits to families in greater need (Cloutier), or by rducing benefits to families with higher incomes (Osberg). It is clear then that this central issue - whether unemployment insurance ought to be insurance or income maintenance - must be resolved before detailed reforms will be possible.[18]

Individuals and families

Another important issue is whether unemployment insurance should be

18 I use the recent policy suggestions of Kapsalis, Cloutier, and Osberg merely to illustrate the point what whether unemployment insurance is regarded as insurance or income maintenance is central to one's opinions about policy. The question is not who is right and who is wrong.

directed towards the family or the individual.[19] The existence of more than one wage-earner in many families, the changing nature of the unemployed, and the influence of other family members on individual work decisions would seem undeniable. Serious research into the joint determination by a family of its expenditures and allocation of market and non-market activities across individuals and over time are rare. Consequently, empirical estimates of the net work disincentives occasioned by moving the Unemployment Insurance Program towards a family orientation are unavailable. Yet the claim is made as a matter of faith that the family is the basic economic unit in Canadian society, and who walks out the door to work in the morning is really a family matter. It may well be the case that a uniform benefit and contribution structure based upon individuals can be designed such that cross-subsidies between employees with different family characteristics are not significant (Kapsalis 1978). But it is simply more realistic to recognize that labour supply decisions, including decisions about participation and unemployment, consumption and savings, mobility and education, and even any incidental 'tax-planning' associated with unemployment insurance are all made within the family. One may well take the viewpoint that if labour supply is a family matter then unemployment insurance should be on a family basis as well. There is, however, much room for disagreement; after all, wage rates are not adjusted for a worker's family responsibilities.

There has been little or no research about how unemployment insurance for families instead of individuals might affect work incentives. Nor do we know what some of the other consequences might be of providing unemployment insurance to the family unit rather than individuals? For example, will making payments to families encourage marital instability and the splitting of families? Cloutier and Smith (1980) recently conducted a simulation based upon the year 1975 in which the family is the insured unit. Individual insurable earnings are calculated as usual and aggregated into a family unit amount. Benefits are paid on the difference between family insurable earnings and the employment earnings of employed mem-

19 Whether unemployment insurance is delivered to individuals or families is a real issue and not a mere detail. Incidentally, the Income Tax Act is also, to use Osberg's phrase, creeping towards Carter. A related issue concerns earnings as opposed to income. In the context of the work dimension of unemployment insurance, surely earnings are the relevant base. Income becomes more relevant as we move away from

bers. In essence earnings of individuals exceeding the individual insurable earnings are first used to cover the lost earnings of the unemployed members of the family. Cloutier and Smith report a possible reduction of 10 per cent of total benefits, that these reductions, as expected, are highly progressive, and that they are 'overwhelmingly concentrated on wives in middle- and upper-middle-income families' but 'benefits to female heads of families are virtually untouched.' One difficulty with Cloutier and Smith's results is that this increase in target efficiency and progressivity might be at the cost of denying working women the equality, flexibility, rights, and benefits that society now feels should be accorded them.

Cloutier and Smith conclude by mentioning that one possible result of a family-based unemployment insurance plan is that 'families might ... adapt by changing family composition' (ibid. 71). The issue is whether cash transfers keep families together or tear them apart. Research on this important question is still meagre, but a recent review of the evidence by Bishop (1977) suggests that having a job will tend to reduce marital instability but that cash transfers in general are more equivocal. The findings to date suggest that income assistance may increase marital dissolution. The entire subject of income security and family stability requires serious research as well as policy clarification.

Effective wage rates, taxes, and work tests

The emphasis in the Unemployment Insurance Program on replacement of earnings is suitable if unemployment is involuntary, temporary, unexpected, and restricted to persons who usually have permanent jobs, have marketable skills, and know how to look for a job. But what about the segment of the labour market with low skills, intermittent job histories, scant information about jobs or training opportunities and which works randomly in secondary-sector, low-wage, 'bad' jobs?[20] For the latter group unemployment insurance raises different issues. Two of these

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the pure job aspect to broader issues of social security.

20 The distinction being drawn here is between the so-called primary and secondary sectors of the dual labour market hypothesis. The dual labour market hypothesis need not concern us directly except to note that the discussion of unemployment insurance used by the works reviewed in this

issues are the marginal tax rate, or effective wage rate, and the work test. We have remarked that the Canadian Unemployment Insurance Program has prohibitively high marginal tax rates in that the income gained from switching from unemployment benefits to work is extremely small.[21] This discourages secondary-sector workers from seeking permanent jobs, holding onto jobs, or demanding training opportunities. Unattractive, low-paid, dead-end jobs might just as well be replaced by unemployment benefits, especially since the extra income returns to work are so meagre. It was precisely the recognition of this fact that moved the Castonguay-Nepveu Report (Quebec 1971) to recommend a 'low' benefit-reduction rate for the employable working poor and led the recent Federal-Provincial Social Security Review to concentrate on the 'working poor.'

If the target clientele of the Unemployment Insurance Program indeed do not have sufficient labour skills, market information, or training, the nature and function of the work test assumes importance. By work test is meant the screening process by which labour-force status and hence eligibility for benefits of claimants are determined. It is of course true that such tests are often imperfect and can be abused by administrative discretion in order to limit program costs, diminish the number of claimants, and the like (see Felder 1979). But the work test can also be construed as an evaluative measure and can therefore represent the contact and entry point for manpower policies such as counselling, retraining, and, so on.[22] This was surely the reason for merging benefit payment and manpower functions in 1977, although one fears that administrative functions have been merely centralized. To summarize: although both theory and empirical work have concentrated on the earnings-replacement or benefit/wage ratio in investigating induced unemployment, the tax rate and

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paper is not based on this theory. It falls instead within the so-called neoclassical view.

21 For technical reasons I dislike calling this phenomenon a marginal tax rate effect. I prefer the term 'notch effect,' which is often used to describe program discontinuity effects. The point remains that for an unemployed worker to take a short-term, unattractive, low-skill job with no chance for advancement or training instead of unemployment benefits constitutes a lousy exchange. Without a 'truly' marginal tax rate, in the sense that overtime premiums are marginal because they are restricted to that extra hour of work, the Unemployment Insurance Program is currently structured so as to foster 'bad work behaviour' on the part of the secondary workers.

22 See Munts (1971) for a good discussion of other issues pertaining to the work test.

work test questions, particularly for secondary labour markets, are also important.

Jobs, cash benefits, and delivery mechanisms

Let us grant that unemployment insurance induces some measure of work disincentive. Let us grant also that labour market efficiency and income maintenance are also important objectives that are served by unemployment insurance. The problem then is to find the best program under those circumstances. In other words, what alternatives or remedies to the Unemployment Insurance Program are at hand? Since unemployment insurance is at present directed towards the work world, it is not surprising to find an overriding concern with preserving work incentives. However, unemployment insurance might be supplemented by wage subsidies, earning subsidies, or job tax credits.

These proposals are all aimed at maintaining work incentives as well as creating jobs. The wage-rate subsidy is a suggestion that the government pay individuals a certain amount per hour of work. The amount is usually equal to a specified percentage of the difference between a target wage rate and the worker's actual wage rate. The earnings subsidy is paid to workers on the basis of total earnings. Up to some predetermined level of earnings, a payment equal to some fraction of earnings is paid. Beyond this level the subsidy declines by some percentage of the amount by which earnings exceed the specified level. Since Canadians are now familiar with the tax credit principle, an earned income tax credit could be implemented.[23] Job tax credits are the counterparts for employers; they give employers a credit against personal or corporate income tax liabilities for new jobs created.[24]

These proposals provide incentives that affect both the demand and supply sides of the work place. Wage and earning subsidies should be work incentives for workers, and job tax credits should encourage the

23 Quebec has proposed an earning subsidy program, although it is often referred to as an income supplementation plan. Up to some predetermined level, the subsidy is 25 per cent of earnings. Beyond the level, the benefit reduction (tax back) rate is 33 1/3 per cent. The relevant income definition unit is the family. Other transfers, including UIC benefits, are taxed at 100 per cent. See Tamagno (1979) for a description of the proposal. The proposal bears a striking resemblance to ideas first outlined in the Castonguay-Nepveu Report (1971) and to the detailed design of an experimental negative income tax. (Hum 1979c).

24 See Bishop and Lerman (1977) for a further discussion.

creation of jobs by industry. These measures are not without their own difficulties. While avoiding the work disincentive inherent in income maintenance programs that provide unearned income transfers (unemployment insurance, social assistance, or negative income tax), wage and earnings subsidies are totally inadequate for families whose only workers are unemployed. Thus unemployment insurance, whether viewed as insurance or income maintenance, has a valuable and central contribution to make. But it is only a single program and must be part of a wider strategy for family income security.

We noted that governments in modern industrial economies now accept responsibility for maintaining employment. The provisions in the current Unemployment Insurance Program whereby unemployed workers are entitled to extended benefits in the event of high national or regional unemployment rates is testimony that governments can fail in their responsibilities as often as individuals. The phrase 'jobs versus cash' usually refers to the question whether it is not more socially beneficial for governments to create jobs directly instead of merely making cash payments to the unemployed. This is a tantalizing topic we shall not pursue. But 'jobs or cash' can also be taken as a sign of government failure to provide full employment with the traditional aggregate monetary and fiscal policies. If the government cannot maintain an economy with enough jobs, then it must pay out the 'cash.' Whatever the exaggerated claims of economists, the detailed workings of labour markets are still not fully understood. The debate over the causes of unemployment continues unabated. Add to that our moral sentiments about the work ethic, and is it any surprise that programs like Unemployment Insurance are contentious? But as long as the government fails to maintain full employment, there will be many in our society who will have no choice between work and unemployment insurance benefits. These are the involuntarily unemployed, compared to whom the amount of insurance-induced unemployment appears insignificant.

SUMMARY AND CONCLUDING REMARKS

This paper has focused upon one program, unemployment insurance; a single side of the labour market, supply; and one particular economic view of the work world, the neoclassical model. An investigation of the work-disincentive effects of unemployment insurance is clearly an incomplete evaluation of the program since there are also beneficial features as well as

other economic objectives. Unemployment insurance cannot be viewed in isolation from the total social security system any more than labour markets can be examined apart from the total economy, and that must be kept in mind when evaluating the role of unemployment insurance in income maintenance, manpower, and economic policies, since what makes little sense in isolation may well seem sensible when placed alongside complementary programs. My own view is that Canada lacks any broadly based income maintenance program that includes the working poor as part of the target population. Failing this, unemployment insurance has had to function both as wage-loss insurance and as a poor substitute for an income maintenance system, albeit sharing these burdens with social assistance and other demogrants or tax credits. This situation explains much of the controversy and present contradictions. I would hope that Canada's longer-run objective would be a comprehensive and universal family income-maintenance policy. Whether the system should be based upon the negative income tax, the credit income tax,[25] universal demogrants, or wage or earnings subsidies is beyond the scope of the present paper. But if this vacuum is partially filled, I would prefer that unemployment insurance continue to be directed at the individual, and focused primarily, but not exclusively, on wage-loss replacement. Unemployment insurance benefits should continue to be taxable income to the individual, and not income to the higher-earning spouse as Osberg (1979a) has suggested. I do not favour unemployment insurance based upon family insurable earnings (Cloutier and Smith 1980).

The basis for my position is that unemployment insurance should play a pivotal but less than total role in the maintenance of family income. Thus, while income support can, and perhaps ought, to be given to the family unit for purposes of redistribution or earnings supplementation, there is no reason why unemployment insurance should not remain primarily a replacement of lost wages for individual workers with benefits fully taxable as individual earnings. In addition, retaining unemployment insurance on an individual rather than a family basis respects the right of women to full legal participation in the work place and reflects a neutral attitude to marital instability. Coverage by unemployment insurance should also continue to be universal and compulsory because wage-loss insurance is a merit good. The argument that unemployment insurance should be

25 See Kesselman and Garfinkel (1978) for a discussion of some of the issues concerning an NIT as opposed to a CIT.

governed by strictly private insurance standards (presumably, including voluntary participation) cannot be pushed too far. The objections to this view have been amply stated (Cloutier 1978, Osberg 1979a). However there are two technical arguments that seem to have been omitted. The first is that asymmetry of information about the risks of being unemployed can lead to market failure in the provision of insurance due to the principle of 'adverse selection' (Akerlof 1970). Secondly, recent theoretical work on the design of optimal insurance policies have demonstrated how an actuarial constraint will lead a risk-averse insurance seller to impose upper limits on coverage (Raviv 1979).[26] The implication of these arguments is simply that private insurance for unemployment may not work, either because no market will exist or because, even if it should exist, the ceiling on insurable earnings dictated by actuarial considerations may not be high enough to maintain income. Hence, suggestions for altering current ceilings on maximum insurable earnings (Kapsalis 1978) or for a 'voluntary, flexible, private insurance supplement to a basic, public unemployment insurance program' (Cloutier and Smith 1980, 42) must be viewed with scepticism. If the above is correct, then this moves the welfare economics question of unemployment insurance (including financing) much closer to the usual arguments about expenditures on public goods. This would also militate against the financing philosophy behind the private insurance approach, whereby contribution rates vary strictly according to the risk of unemployment. Viewing unemployment as a 'social bad' requires that compensation for its victims be financed at large, and in this regard the frequent suggestions for greater experience rating and the more recent ideas of work-sharing (e.g. Reid 1980) are most welcome. Taken together they promise more equity as well as efficiency. Experience rating, which requires firms with unstable labour demand, such as seasonal employment patterns, to contribute relatively more to the financing of the Unemploy-

26 A full account of these subtle and technical arguments would, I believe, take us too far afield. Akerlof's basic point concerns the implications of different degrees of information. In the present context it may be supposed that the individual will always have better information about his or her probability of being unemployed than will the insurer, hence this asymmetry of information will always exist even with risk rating, etc. Raviv's point is simply that insurance companies hate to lose money and therefore actuarial considerations will dictate full coverage of small losses and limited coverage of large losses. In the present context this could mean hardship for the unemployed with large families or previously high wages or long periods of unemployment, etc. Neither of these points has ever been considered, to my knowledge, in any discussion of unemployment insurance.

ment Insurance Program, is more equitable because such firms benefit relatively more from an unemployment insurance program than do other firms. In addition, the availability of unemployment insurance contributes to structural unemployment (Grubel et al. 1975a, 181) and makes the unstable sectors larger than they would otherwise be (Bird 1976). More experience rating would moderate this permanent hidden subsidy by stable to unstable industries and increase overall efficiency. The notion of work-sharing is also based upon a desire for greater equity. Work-sharing entails a small reduction in the hours worked per employee rather than complete layoff for a few in the face of a firm's diminished demand for workers. It reduces the number of persons totally unemployed and requires the co-operation of the Unemployment Insurance Program in allowing workers on short-time to receive partial benefits. Canada has experimented with such arrangements in an ad hoc fashion. Perhaps it should now formalize the procedures by which firms and the Unemployment Insurance Program can negotiate such 'employment treaties.' In sum then, I recommend that unemployment insurance continue to be universal, compulsory, and directed towards individuals primarily for the replacement of lost wages, but - and this is a big but - this is contingent on the existence of some complementary, broadly-based, family income security measures. Failing the latter, alternatives should be adopted that would minimize administrative disruption and be capable of harmonization with any eventual income maintenance proposal.[27] Experience rating and work-sharing appear to be two interesting reform options for the short run.

The neoclassical framework, which forms the basis of much thinking about the influence of unemployment insurance, must be approached with extreme caution. Low-income unemployed workers may not be identical to high-income employed workers except for having less income and no job. Hence policies based upon this premise may be either inadequate or misplaced. There is undoubtedly discrimination in the labour market and a lack of complete occupational, geographical, and sectoral mobility of

27 This may seem vacuous but clearly no more can be said without a detailed outline of the accompanying alternatives. Perhaps this example will help. If greater progressivity in family incomes is desired now, then Osberg's scheme of taxing UI benefits at the tax rate of the higher earning spouse is to be preferred to Cloutier and Smith's suggestion for a family-based program on the grounds of minimizing administrative disruptions, now and in future, and maximizing the potential for eventual harmonization with some future program. I realize this discussion is less than satisfactory.

labour. In short, far more attention must be paid to the structural features of labour markets, including the demand for labour by firms. Specifically, if the Canadian labour market consists of two distinct sectors, unemployment insurance programs in particular and income maintenance policies in general may not solve the long-term problem of unemployment. The dualist interpretation of unemployment argues that many of the unemployed inhabit the secondary labour market - a job sector characterized by low wages, poor promotion prospects, unfavourable training opportunities, unattractive low-skill jobs, and little possibility of entry to the primary sector. The primary sector is characterized by well-paid, attractive, secure jobs. This being the case, the secondary labour force is composed of disadvantaged and discouraged groups who 'demonstrate' poor work habits by interchanging bouts of employment in distasteful jobs with periods of unemployment insurance benefits or welfare. The implications of this abbreviated description of the dualist position for unemployment policy are twofold. First, unemployment insurance provides short-term income relief only. By their nature, income transfers will not modify work habits or job skills very much. Giving income transfers to the unemployed may allow them to continue to shop, but it will not enable them to work if there are no jobs available or if they are unable to get or keep jobs. It may be less a problem of unwilling labour supply than of reluctant demand for labour. Ironically, the need for income transfers may be less than the need for the now unfashionable in-kind vocational services.

On the premise that demand-side policies must also be considered, attention has turned recently to public employment and subsidized supported-work strategies. These are designed for persons with serious employment difficulties, such as those with little or no successful experience in the labour market. The underlying assumption is that these workers 'can be successfully employed ... under close supervision by technically qualified people who understand the work histories and personal backgrounds of [these] members. The goal is ... to enforce gradually increased standards of attendance, productivity and performance' and to move these workers 'eventually into unsubsidized permanent employment' (Masters and Maynard 1979). These strategies are directed to the demand side of the labour market and can be implemented in a variety of ways, such as by public employment strategies or new job tax credits. They can also be implemented through either the public or the private sector (see Bishop and Haveman 1979, Masters and Maynard 1979, and Haveman and

Christainsen 1978). While it is premature to predict that supported work programs, wage subsidies, public sector direct job creation, and the like will be successful, there is evidence from Western Europe and the United States that 'suggest that they have not been viewed as failures in achieving the primary objective - employment increases - set for them' (Haveman and Christainsen 1978, 87).

While unemployment insurance is both necessary and laudable, it is only a small part of income maintenance and employment policy. The continuing debate over unemployment insurance and the large demands placed upon the program highlight the lack of a co-ordinated policy for income maintenance in Canada. At the same time the picture painted by the segmented labour market theorists implies that attention must now be paid to policies that enhance the direct creation of jobs and attack individual and structural barriers in the work place.

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